Proposed Mergers of SBC/AT&T and VZ/MCI: Preliminary Analysis of Competitive Effects

Professor Simon J. Wilkie
California Institute of Technology

Dockets 05-65 & 05-75
June 14, 2005

Competitive Issues

- Direct horizontal overlap in markets for ***wholesale local facilities***

- Flow-through of effects in wholesale market to create adverse effects in retail markets
  - Voice and data services purchased by businesses (large, medium, and small)

The Local Wholesale Market

- As a result of competitive entry, today there exists a functioning market (albeit imperfectly) for wholesale local facilities that enables retail customers to have a choice of competitive providers.

- AT&T and MCI play a critical role as the major wholesale suppliers to other competitive providers at rates far below ILEC special access rates by (1) reselling their own facilities in their entirety or (2) reselling a combination of their own facilities and facilities purchased from the ILEC at substantial discount.

- As the facts demonstrate, if AT&T and MCI exit the market, the number of wholesale suppliers is dramatically reduced. As a result, both competitive providers and retail customers will see substantial price increases.

Wholesale Local Facilities

- Possible relevant product markets
  - "Loop": transporting voice and data from the customer's premises to the closest central office ("CO")
  - "Local Transport": transporting voice and data from CO to CO ("interoffice transport") and/or CO to carrier's point of presence ("POP")
  - Wholesale customers sometimes buy the combination of loop and local transport ("Local Access")

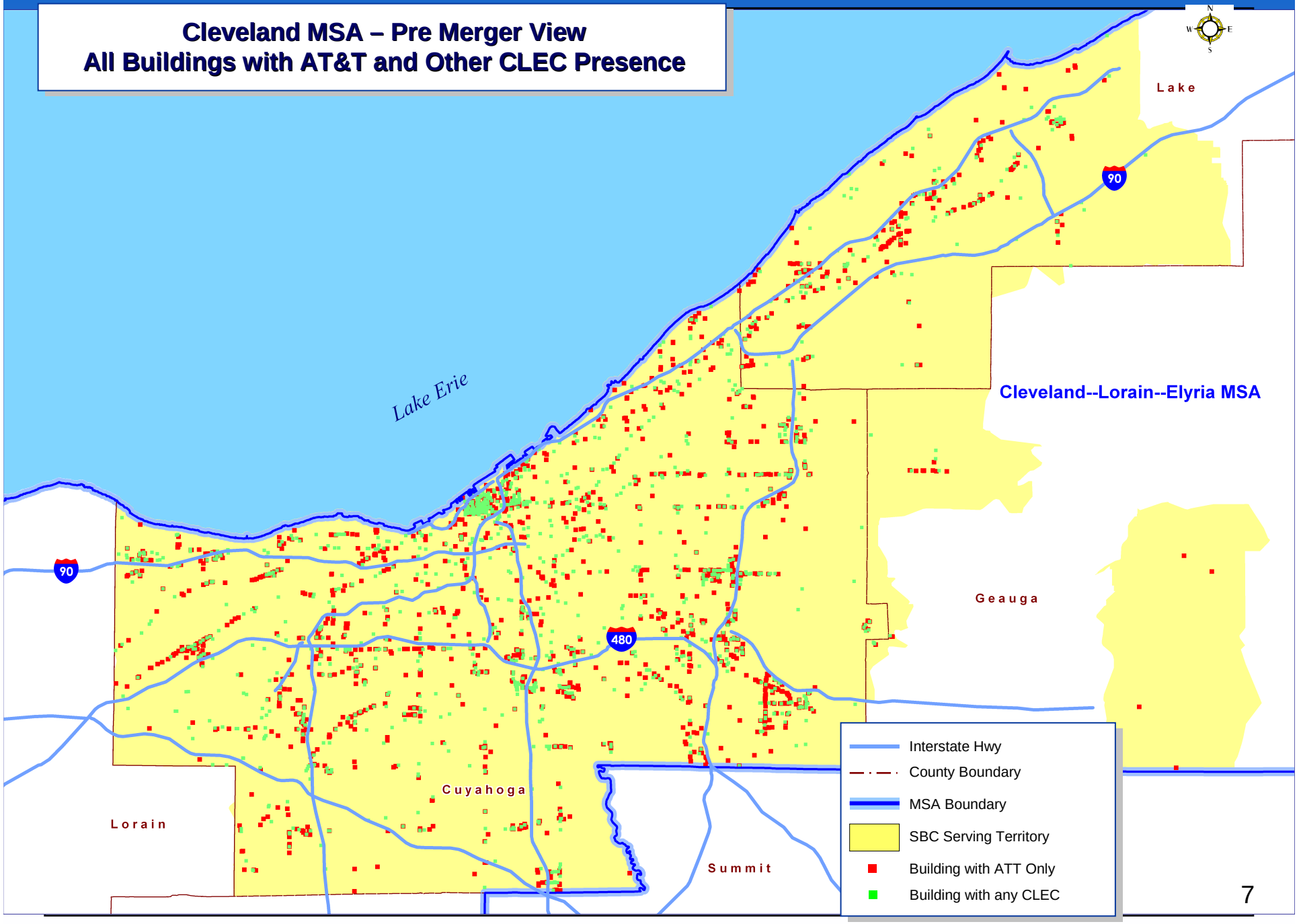
Loop Market

- Relevant geographic markets
- Buyers are Competitive Providers, including CLECs, IXCs, DLECs
- Suppliers are ILEC and Competitive Carriers

Loop Market

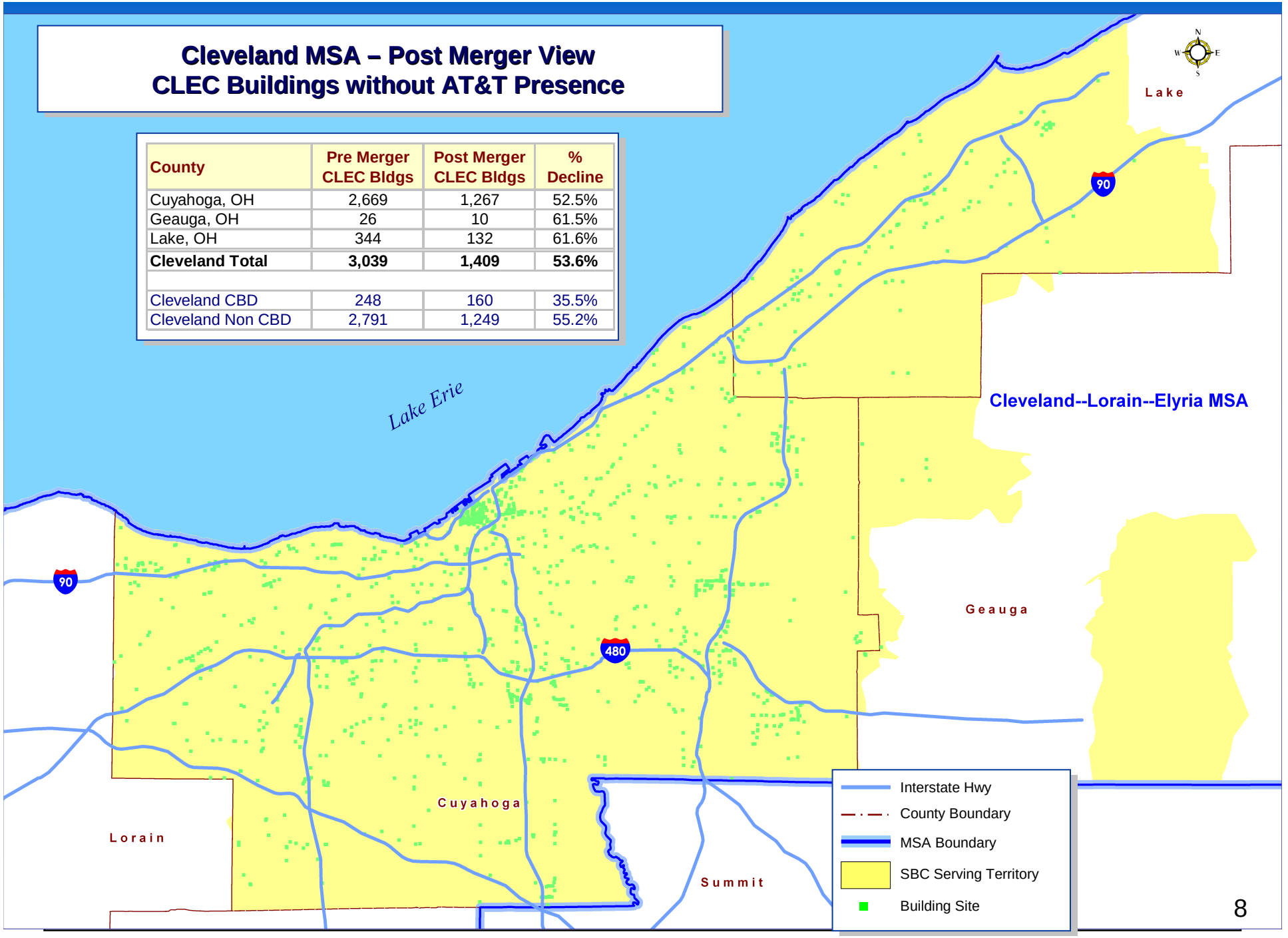
- Measuring market structure
  - Collected data on *bandwidth demand* by building (GeoResults)
  - Collected Competitive Carriers' "lit building lists" for *carrier supply*
- Assigning market shares
  - Assume ILEC serves all buildings in its service area
  - Lit building lists show which Competitive Carriers provide wholesale service to specific buildings

Cleveland MSA – Pre Merger View
All Buildings with AT&T and Other CLEC Presence



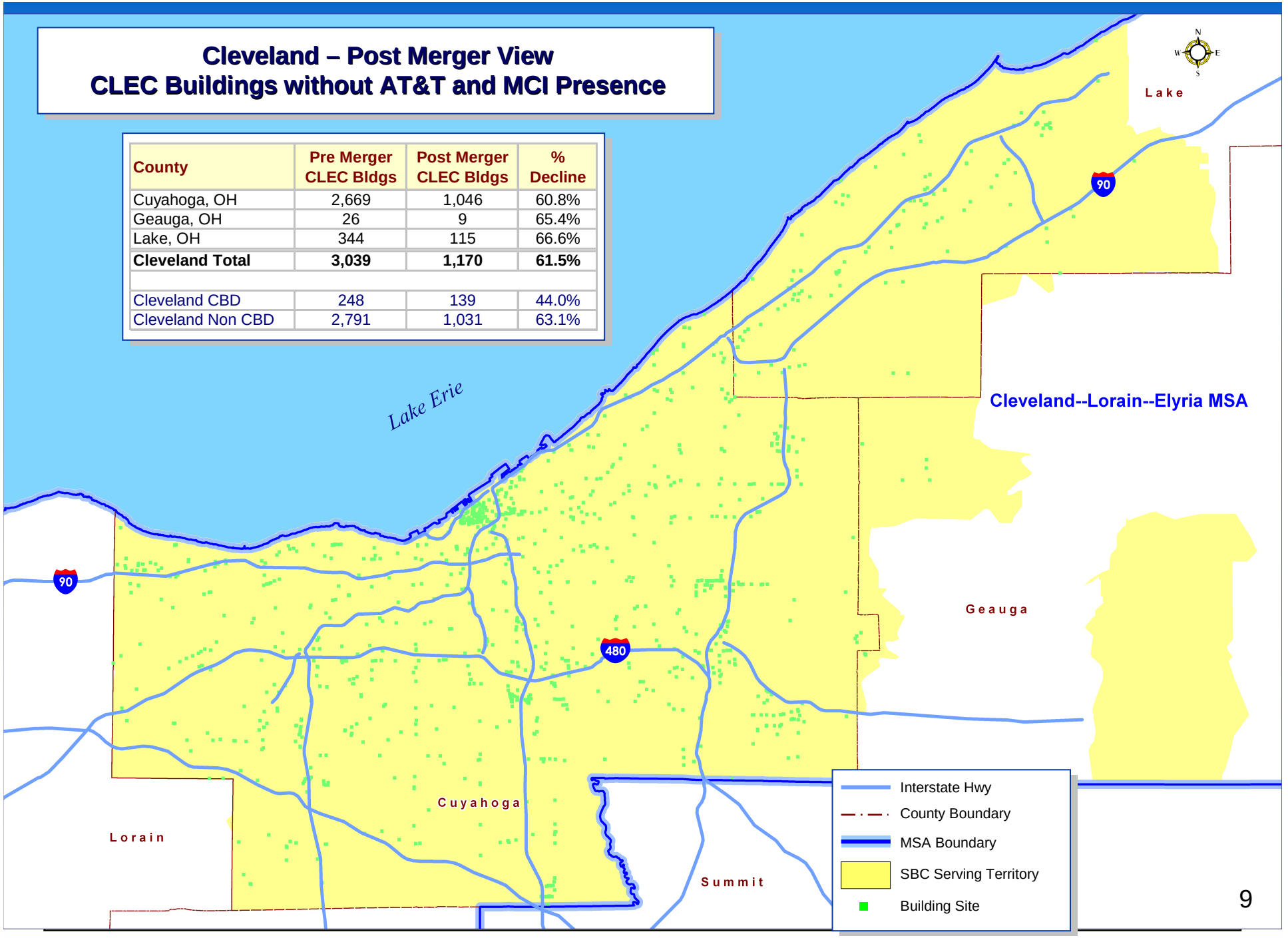
Cleveland MSA – Post Merger View
CLEC Buildings without AT&T Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Cuyahoga, OH	2,669	1,267	52.5%
Geauga, OH	26	10	61.5%
Lake, OH	344	132	61.6%
Cleveland Total	**3,039**	**1,409**	**53.6%**
Cleveland CBD	248	160	35.5%
Cleveland Non CBD	2,791	1,249	55.2%

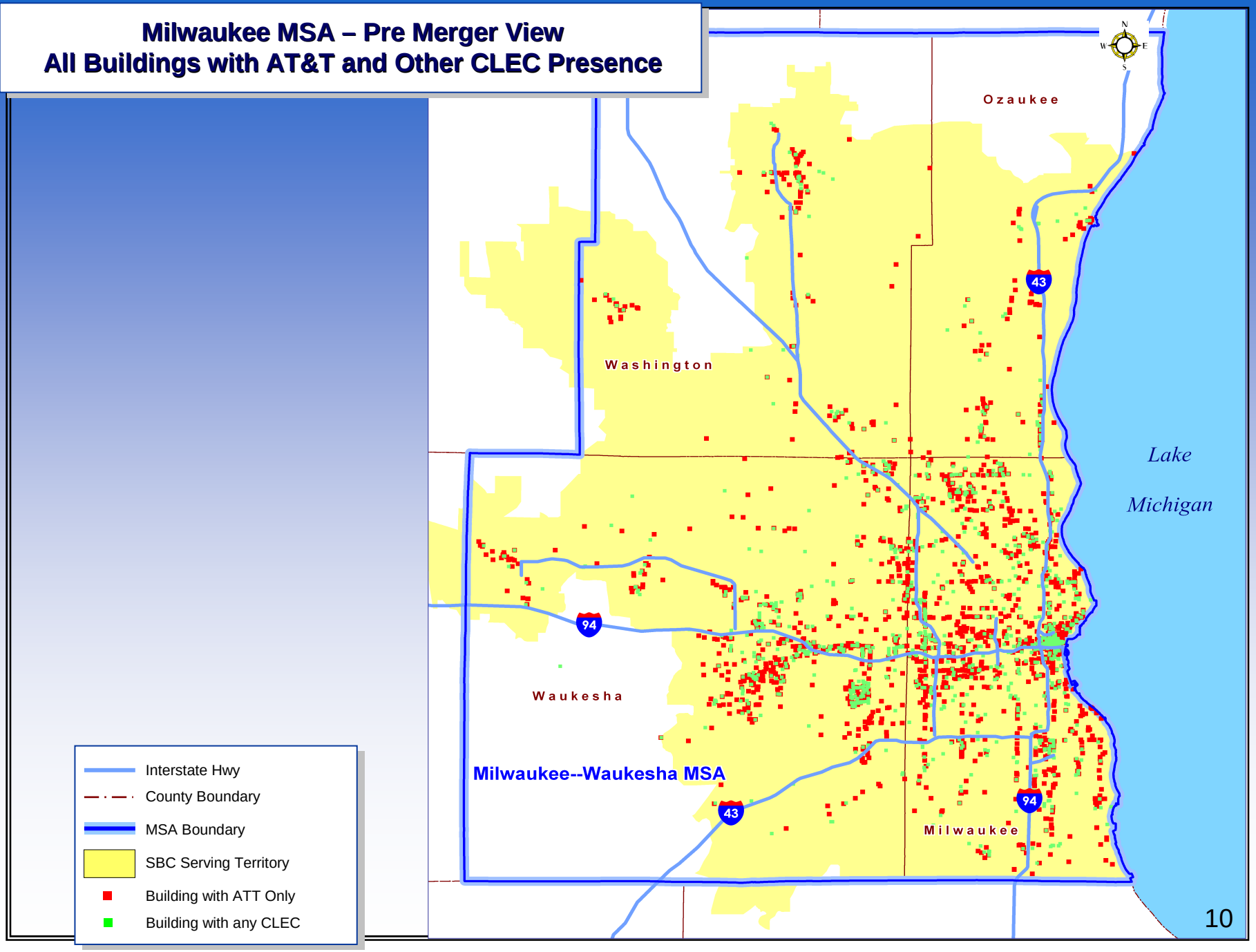


Cleveland – Post Merger View
CLEC Buildings without AT&T and MCI Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Cuyahoga, OH	2,669	1,046	60.8%
Geauga, OH	26	9	65.4%
Lake, OH	344	115	66.6%
Cleveland Total	**3,039**	**1,170**	**61.5%**
Cleveland CBD	248	139	44.0%
Cleveland Non CBD	2,791	1,031	63.1%

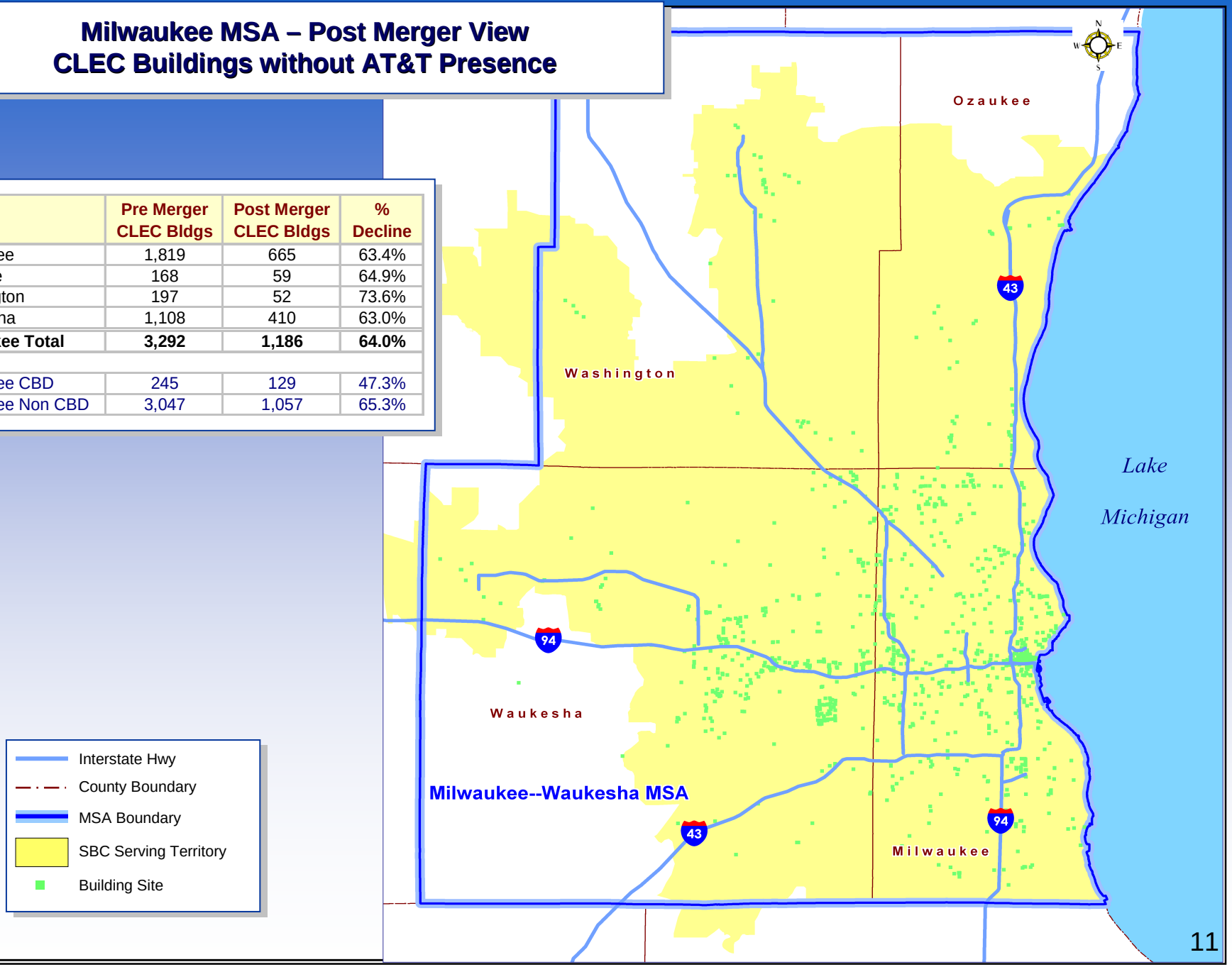


Milwaukee MSA – Pre Merger View
All Buildings with AT&T and Other CLEC Presence



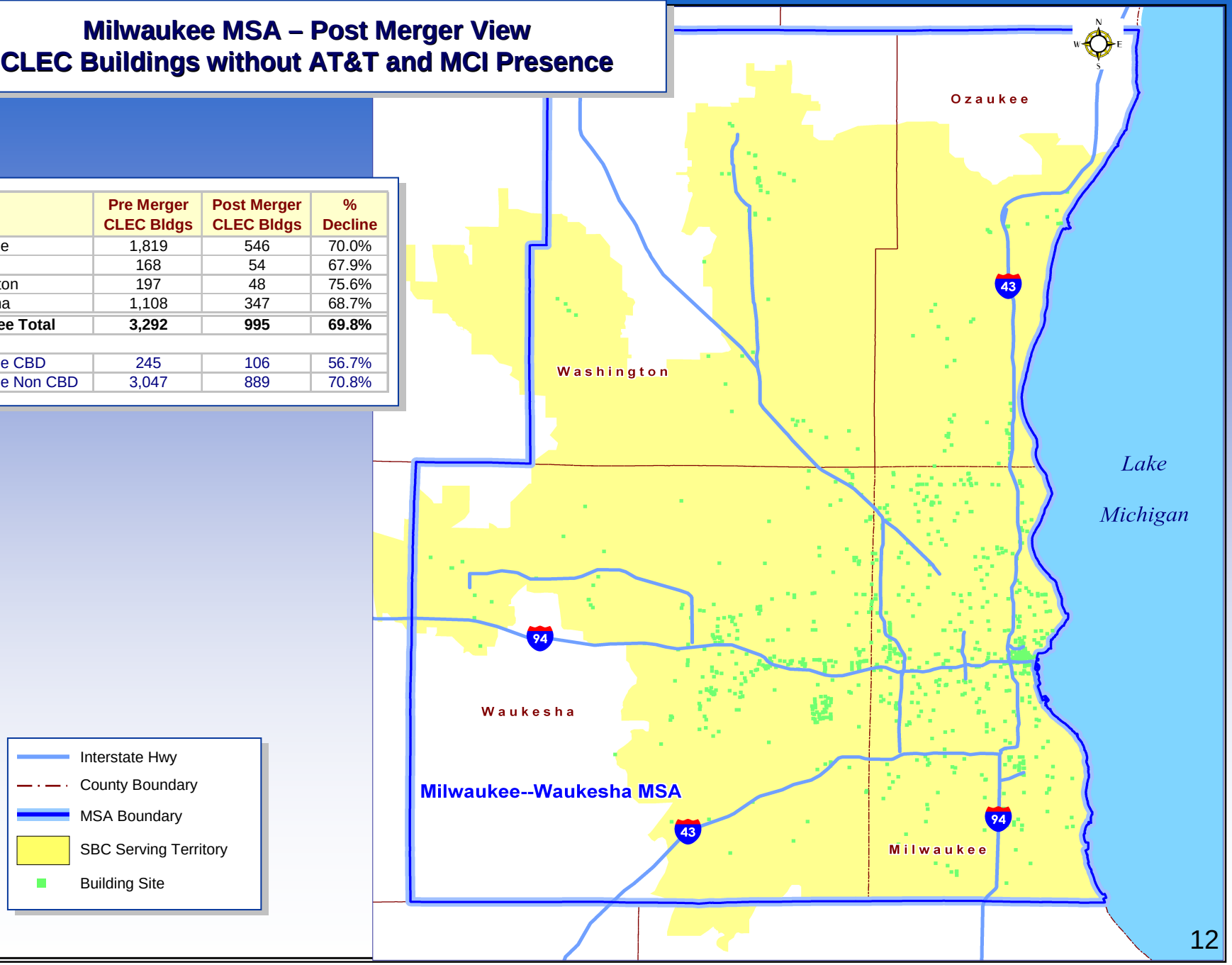
Milwaukee MSA – Post Merger View
CLEC Buildings without AT&T Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Milwaukee	1,819	665	63.4%
Ozaukee	168	59	64.9%
Washington	197	52	73.6%
Waukesha	1,108	410	63.0%
Milwaukee Total	**3,292**	**1,186**	**64.0%**
Milwaukee CBD	245	129	47.3%
Milwaukee Non CBD	3,047	1,057	65.3%



Milwaukee MSA – Post Merger View
CLEC Buildings without AT&T and MCI Presence

County	Pre Merger CLEC Bldgs	Post Merger CLEC Bldgs	% Decline
Milwaukee	1,819	546	70.0%
Ozaukee	168	54	67.9%
Washington	197	48	75.6%
Waukesha	1,108	347	68.7%
Milwaukee Total	**3,292**	**995**	**69.8%**
Milwaukee CBD	245	106	56.7%
Milwaukee Non CBD	3,047	889	70.8%



Loop Market HHIs
Lit Buildings in Los Angeles – Verizon Territory

Criterion for Including Buildings	Number of Buildings	Pre-Merger HHI	Post-Merger HHI	Change in HHI	Market Shares (%) Capacity Based		
					Verizon	MCI	AT&T
All Buildings	104,540	9,340	9,751	411	96.6	2.1	1.0
Buildings with Bandwidth Demand of at Least T1	5,674	8,881	9,576	695	94.1	3.7	1.8
Buildings with Bandwidth Demand of at Least ½ T3	188	7,398	9,099	1,701	85.3	10.0	4.5
Buildings with Bandwidth Demand of at Least T3	55	7,747	9,502	1,755	87.4	10.0	2.6
Buildings with Bandwidth Demand of at Least OC3	7	7,290	10,000	2,710	83.8	16.2	0.0

Source: GeoResults and Competitive Carrier Lit Building Lists.

Loop Market HHIs
Lit Buildings in Los Angeles – SBC Territory

Criterion for Including Buildings	Number of Buildings	Pre-Merger HHI	Post-Merger HHI	Change in HHI	Market Shares (%) Capacity Based		
					SBC	AT&T	MCI
All Buildings	192,102	8,427	8,842	415	91.6	2.3	5.0
Buildings with Bandwidth Demand of at Least T1	11,063	7,677	8,279	602	87.2	3.5	7.6
Buildings with Bandwidth Demand of at Least ½ T3	524	5,965	6,930	965	75.4	6.4	15.3
Buildings with Bandwidth Demand of at Least T3	211	5,630	6,721	1,091	72.6	7.5	17.5
Buildings with Bandwidth Demand of at Least OC3	38	5,345	6,795	1,449	69.5	10.4	20.0

Source: GeoResults and Competitive Carrier Lit Building Lists.

Loop Market HHIs
Lit Buildings in Chicago

Criterion for Including Buildings	Number of Buildings	Pre-Merger HHI	Post-Merger HHI	Change in HHI	Market Shares (%) Capacity Based		
					SBC	AT&T	MCI
All Buildings	241,726	7,005	7,800	795	83.2	4.8	7.2
Top five percent of buildings by bandwidth demand	11,198	5,876	6,928	1,052	75.6	7.0	10.5
Building bandwidth demand at least T3	331	3,670	5,300	1,630	55.5	14.7	18.4
Building bandwidth demand at least OC3	93	3,240	4,837	1,597	50.1	15.7	18.7

Source: GeoResults and Competitive Carrier Lit Building Lists

Local Transport Market

- Relevant geographic markets
- Buyers are Competitive Providers
- Suppliers are ILEC and Competitive Carriers

Local Transport Market

- Measuring market structure
  - Collected data on carriers' responses to request for information
  - Data are offers by carriers to supply circuits
- Assigning market shares
  - Assume ILEC can provide all circuits in its service area
  - Number of DS1 or DS3 circuits offered by a Competitive Carrier in a geographic area

Local Transport Market HHIs in Chicago MSA (By Capacity)

Product	Pre-Merger HHI	Post-Merger HHI	Change in HHI	Market Shares (%)		
				SBC	AT&T	MCI
DS1	3,125	5,351	2,226	47.4	23.5	15.0
DS3	3,125	5,351	2,226	47.4	23.5	15.0
Source: Carrier responses to Request for Information issued by a Competitive Provider						

Summary of Market Structure

- **Loop market highly concentrated**
- **Local transport market highly concentrated**

Evaluating Merger Effects on Prices

- Use price data from Competitive Providers on offer prices for specific circuits
  - Price data for loop markets
  - Price data for local transport markets
- Perform regression analysis on price data to determine increase in bid prices post-mergers

Summary of Price Effects in Loop and Local Transport Markets

- Winning bids are on average 50 percent to 60 percent lower than ILEC special access charges
- The RBOC is almost never the lowest bidder
- AT&T and MCI are by far the most frequent bidders
- AT&T or MCI is the low price bidder most of the time
- There is a significant difference between the winning price and the second-lowest price

Summary of Price Effects in Loop and Local Transport Markets

- Initial regression analyses of the price data show that post-mergers, the wholesale price discount from special access rates would decrease on average by over 15%.
  - (DoJ considers a 5% increase in price to be significant. Here the increase in price is a smaller discount.)

Unilateral Effects: Wholesale Markets

- Large increases in SBC/Verizon market shares in loop and local transport markets
- Largest supplier acquiring second or third largest supplier
- Estimate wholesale price effects using auction theory

Unilateral Effects: Retail Markets

- ILECs and Competitive Providers offer differentiated products
  - Retail prices are a mark-up above marginal costs
- Competitive Providers' marginal costs increase
  - Result is higher equilibrium retail prices
- Increases in marginal costs may foreclose Competitive Providers from serving retail business customers
  - Business customers no longer able to select their first choice of suppliers
- Both effects harm retail business customers

Unilateral Effects: Retail Markets

- Many suppliers of voice and data services use their own facilities
- Retail markets not regulated
- Prices accurately reveal buyers' valuations and sellers' costs

Unilateral Effects: Retail Markets

- Efficiencies claimed by SBC/AT&T and Verizon/MCI will not affect their marginal costs
  - Any efficiencies will not be passed on to consumers in the form of lower prices

Unilateral Effects: Retail Markets

- Claim: SBC/AT&T and Verizon/MCI mergers will result in two efficient, vertically integrated retail suppliers that will compete vigorously on price in all locations
- Response: Not correct, SBC/AT&T will continue to be reliant on Verizon for loop/local transport services in Verizon's service area
- Verizon/MCI will continue to be reliant on SBC for loop/local transport services in SBC's service area

Unilateral Effects: Retail Markets

- To the extent SBC/AT&T achieve cost savings, Verizon/MCI cannot undercut the resulting prices because it will not achieve cost savings in SBC's service area
- SBC will pocket the cost savings and charge prices in its service area approximately equal to the prices charged by Verizon in SBC's service area

Unilateral Effects: Retail Markets

- Assuming the SBC/AT&T and Verizon/MCI mergers result in two efficient, vertically integrated retail suppliers
- Result will be a rise in price to the second most efficient supplier
- Other suppliers would be foreclosed from the market
  - Buyers' demands vary
  - Current suppliers' products are differentiated
  - Explains why so many operate profitably
  - Duopoly outcome will adversely affect business customers by reducing product variety

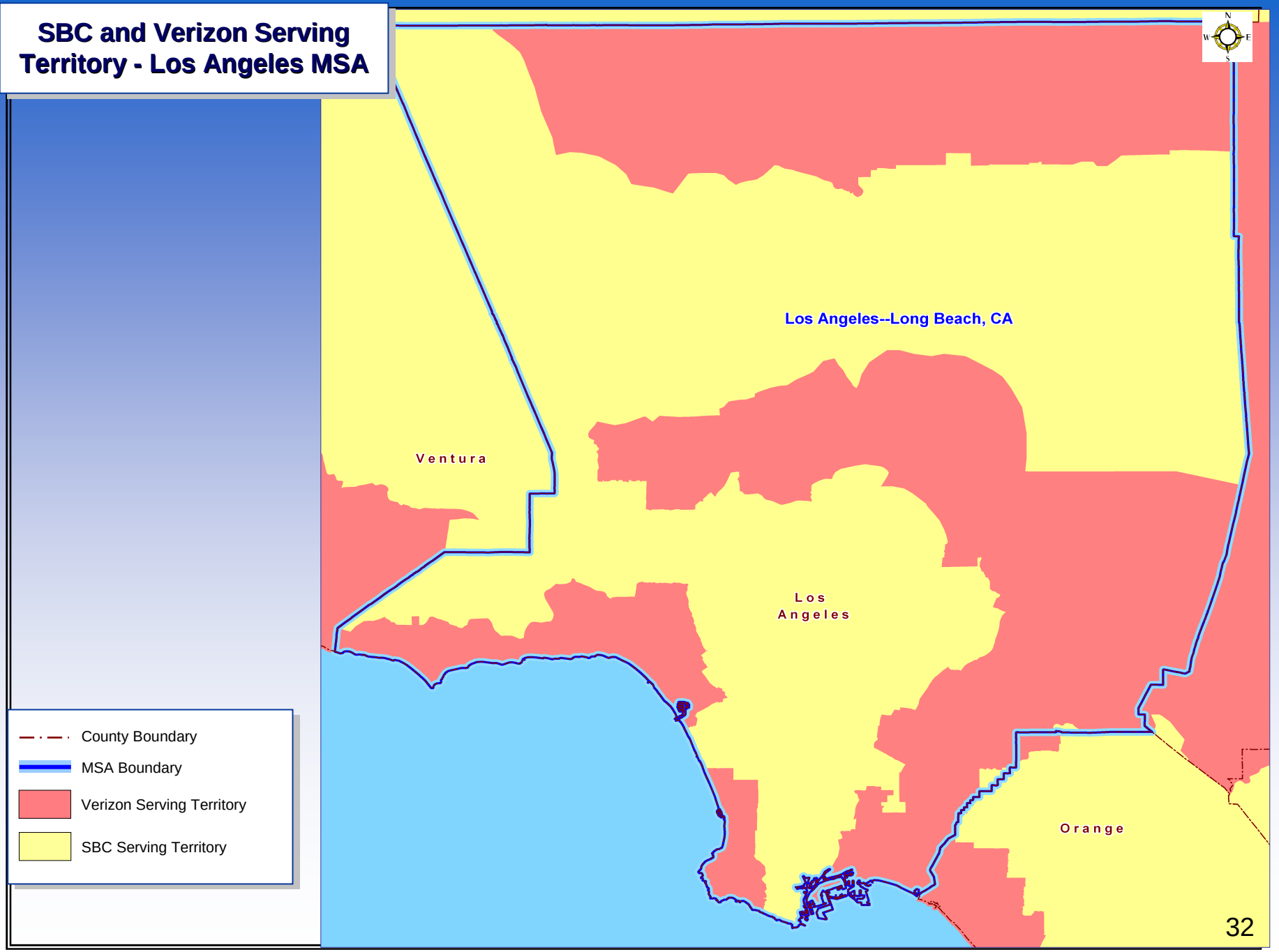
Coordinated Effects

- Make more realistic assumption of post-merger pricing conduct based on past market behavior and economic theory
- Even assuming SBC and Verizon will compete where they both have facilities, this constitutes a small fraction of the area in which they do not both have facilities
- Los Angeles example: SBC and Verizon serve a small number of customers in each other's territories, but tens of thousands of business customers in LA receive service from only one ILEC

Coordinated Effects

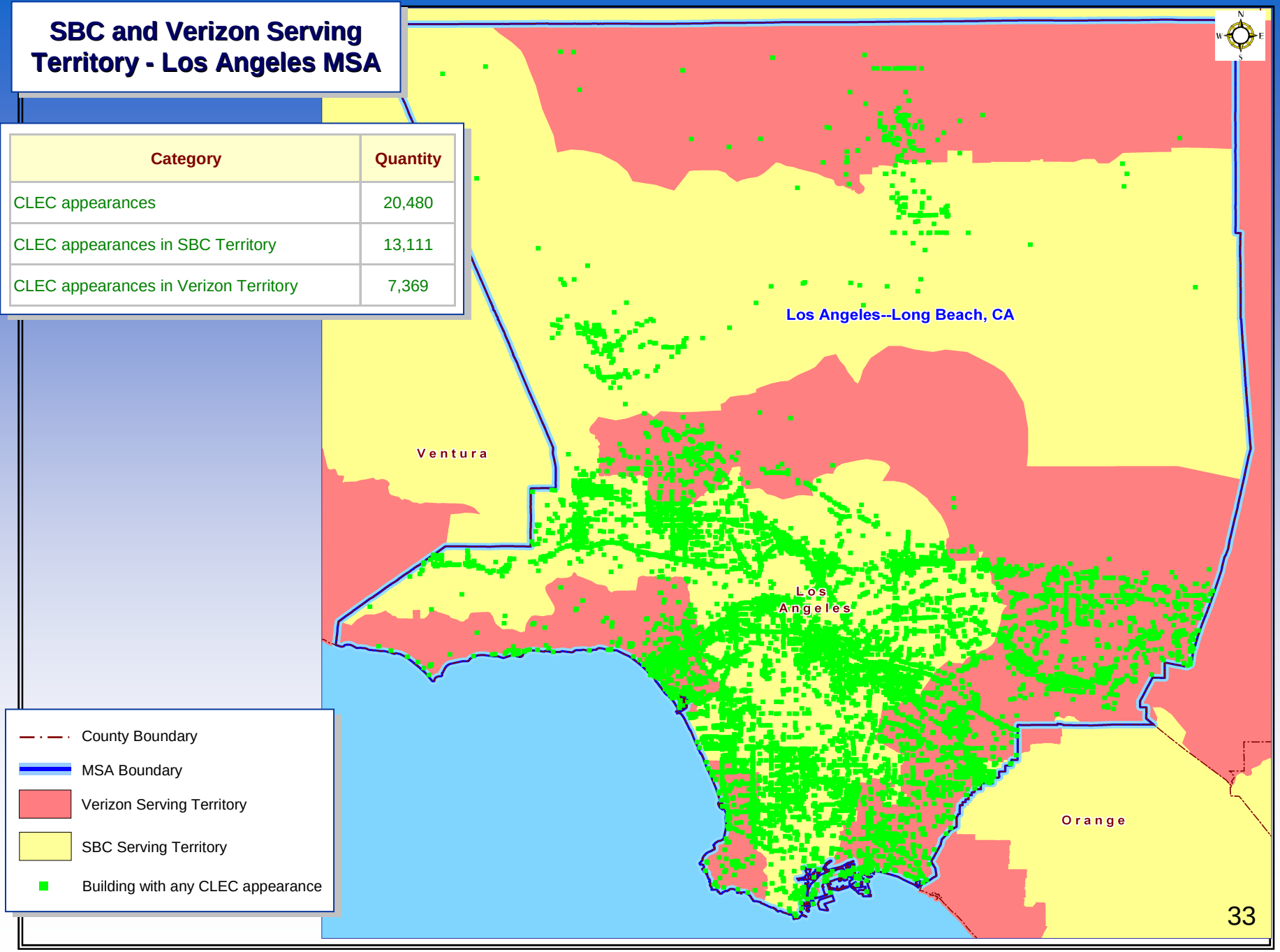
- Likely outcome: mutual forbearance in loop and local transport markets
  - History of such conduct
- Only way to avoid this tacitly collusive outcome would be if SBC and Verizon build local facilities throughout each other's territories
- Not likely given the intense competition that would result

SBC and Verizon Serving Territory - Los Angeles MSA



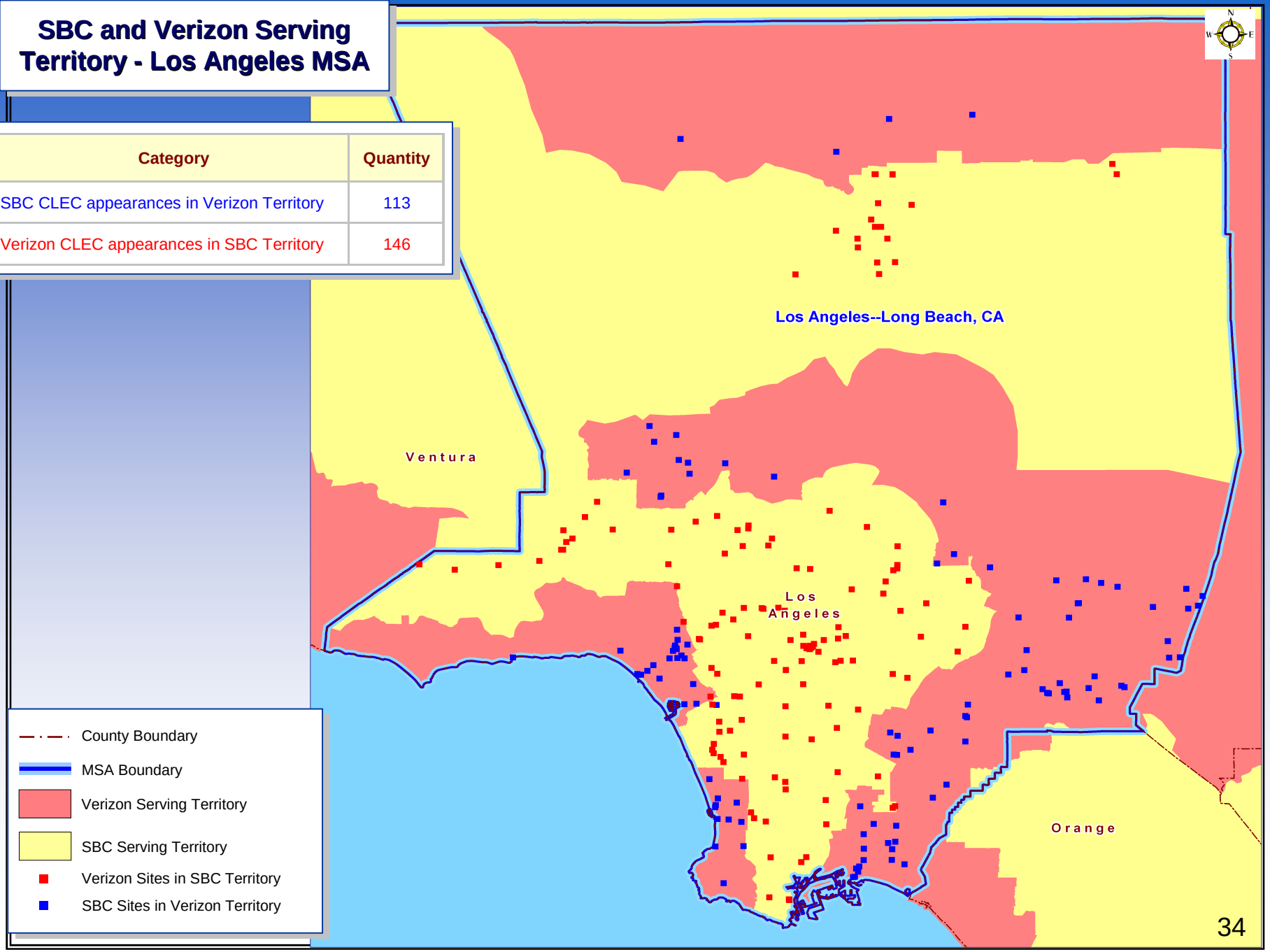
SBC and Verizon Serving Territory - Los Angeles MSA

Category	Quantity
CLEC appearances	20,480
CLEC appearances in SBC Territory	13,111
CLEC appearances in Verizon Territory	7,369



SBC and Verizon Serving Territory - Los Angeles MSA

Category	Quantity
SBC CLEC appearances in Verizon Territory	113
Verizon CLEC appearances in SBC Territory	146



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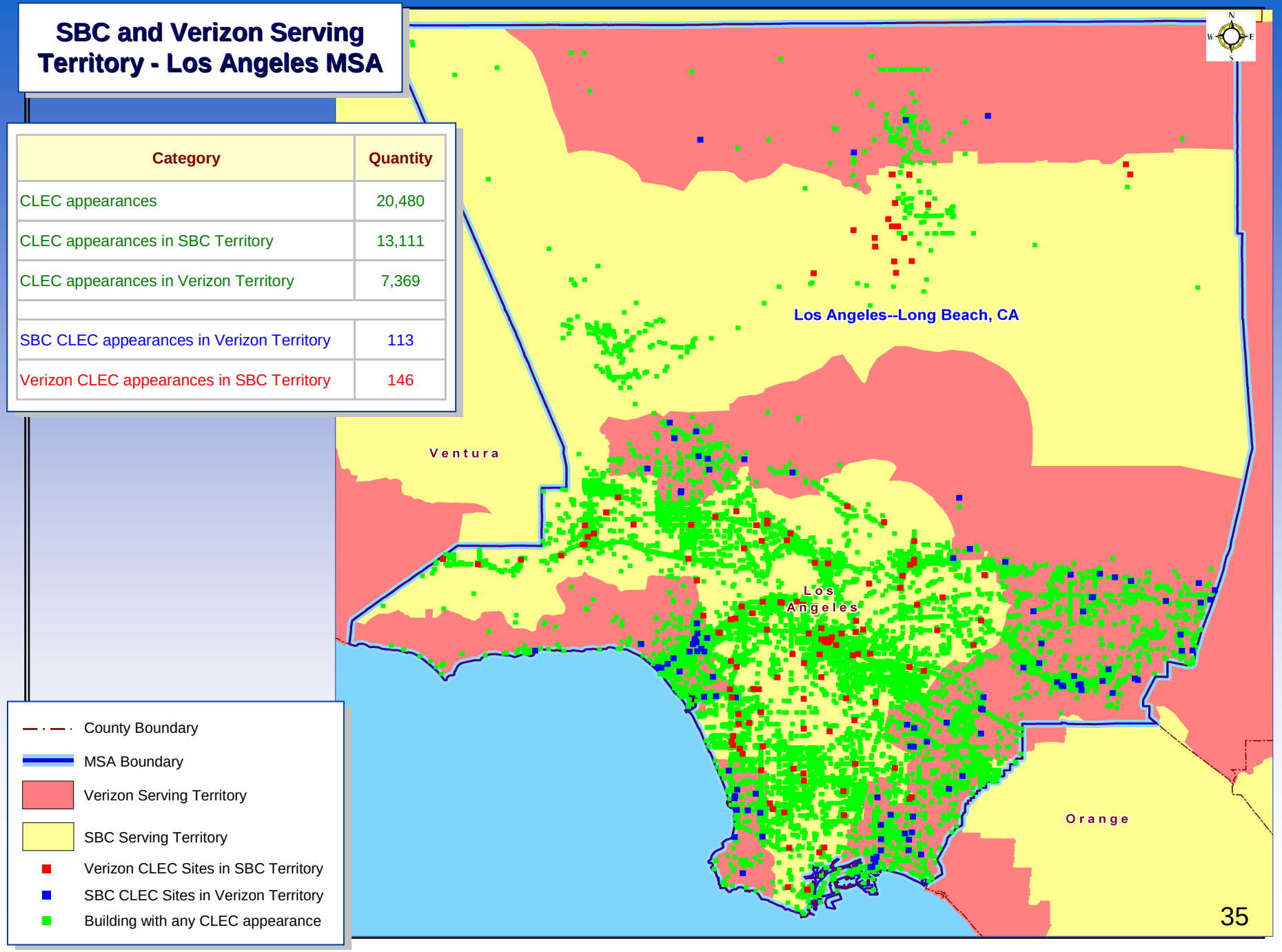

Preliminary Conclusions

- Substantial increases in concentration in already highly concentrated markets
- Significant price increases likely in wholesale markets for local access and local transport
- Significant increases in retail prices paid by business consumers for voice and data services
- History of mutual forbearance